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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 226

S. B. BRINSON AND LEOTA L. BRINSON, PETITIONERS

v.

LAURIE W. TOMLINSON, Director of Internal Revenue for the District of Florida

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (Pet. A-2—A-6) are not officially reported. The opinion of the Court of Appeals (Pet. B-1 - B-5) is reported at 264 F. 2d 30.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1959 (Pet. B-1), and a petition for rehearing was denied on April 22, 1959.

The petition for certiorari was filed on July 18, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the record sustains the findings below that the payment by a partnership of legal fees for services rendered to the individual partners was neither an ordinary and necessary business expense of the partnership nor an ordinary and necessary non-business expense of the taxpayer who was one of the partners.

2. Whether the Court of Appeals correctly held that, in the circumstances of this case, the District Court did not abuse its discretion in refusing to grant a retrial and to permit the taxpayer to offer testimony to supplement a stipulation of facts.

STATUTE AND REGULATIONS INVOLVED

Section 23(a)(1)(A) and (2) of the Internal Revenue Code of 1939 and Sections 29.23(a)-1 and 29.23(a)-15 of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 10-14.

STATEMENT

The facts, as stipulated, and as adopted and found by the District Court (Pet. A-2—A-6), may be summarized as follows:

In 1950, the Brinson Construction Partnership and its partners, including the taxpayer,[1] were investi-

[1] S. B. Brinson is referred to as the taxpayer since only his activities are in issue and his wife, Leota, is a party only because they filed joint individual income tax returns. (R. 1.)

gated by the local Intelligence Unit of the Internal Revenue Service. Special agents as well as Internal Revenue agents participated in the investigation. Subsequently, the case was forwarded to the Department of Justice and criminal prosecution was authorized by that Department against the taxpayer only. (Pet. A-3—A-4.)

On January 12, 1951, charges were filed and a warrant was issued against the taxpayer by the United States Commissioner for the Southern District of Florida. (Pet. A-4.) However, due to the taxpayer's ill health, and in acordance with the then extant Justice Department policy to decline prosecution in a case where a taxpayer's health would be endangered by standing trial, it was decided to decline prosecution, and, on October 3, 1951, the charges were withdrawn. (Pet. A-5.)

After the criminal features of the case were concluded, a settlement was made with the taxpayer with respect to his civil liability for deficiencies in tax and penalties for the years 1943 through 1947. (Pet. A-5.)

A law firm represented the partners with respect to their criminal liabilities, and also represented both the partnership and the partners with respect to their civil liabilities. The law firm charged a fee of $22,500, which was paid by the partnership and deducted by it on its 1951 tax return.[2] The Government disallowed the deduction, which resulted in an increase

[2] This was an information return.

of $22,500 in the partnership's taxable income, and an increase of $11,250 in the taxpayer's taxable income. (Pet. A-5.)

The attorneys' fee issue was submitted by the parties to the District Court on a stipulation of facts; another issue, concerning a debt, was submitted by the parties at the same time to a jury. After the jury decided the debt issue against the Government, and after the attorneys' fee issue was briefed, the taxpayer moved the court to permit the taking of testimony on the latter issue. The District Court denied the motion. (Pet. B-5—B-6.)

The District Court found that the payment by the partnership of the attorneys' fee was not an ordinary and necessary expense of the partnership business and that it was therefore not a deductible item on the partnership return. It also found that such payment was not an ordinary and necessary non-business expense of the taxpayer and was therefore not deductible from gross income on his tax return. (Pet. A-6.) The Court of Appeals affirmed, one judge dissenting. (Pet. B-1—B-15.)

ARGUMENT

The decision of the court below is correct, there are no conflicting decisions, and further review is not warranted.

1. Both courts below correctly concluded on the record here that a payment for attorneys' fees, by a partnership of which the taxpayer was a member, for legal services rendered in part to forestall the taxpayer's criminal prosecution on tax evasion

charges, was not an allowable deduction either as a business expense of the partnership or as a non-business expense of the taxpayer. In order to qualify as a partnership business deduction under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 10), an expenditure must be both "ordinary and necessary". *Deputy* v. *duPont*, 308 U.S. 488. Mere proof of the payment of an expense will not suffice; it must also be shown that the obligation to pay arose out of a transaction customary in the type of business involved (i.e., ordinary), and that it was necessary to make the expenditure. *Commissioner* v. *Heininger*, 320 U.S. 467, 470. Similarly, under 1939 Code, Section 23(a)(2) (Appendix, *infra*, p. 10)—permitting deduction for an expense relating to the production or collection of income, or the management or conservation of property held for the production of income—the expense must also be "ordinary and necessary". *Trust of Bingham* v. *Commissioner*, 325 U.S. 365, 374; see also, *Lykes* v. *United States*, 343 U.S. 118, 123.

The Court of Appeals (Pet. B-5), as did the District Court (Pet. A-6), held that the taxpayer failed to show that the part of the attorneys' fees paid for services rendered in forestalling criminal prosecution of the taxpayer was an expenditure falling into either of the above two categories.[3] The stipulation, which

[3] In unwarrantedly assuming the existence of certain facts in the record, the dissenting opinion below (Pet. B-7—B-15) fails to recognize that the taxpayer had the burden of proving that the expenditure in question qualified as a deduction either under Section 23(a)(1)(A) or 23(a)(2). While it is true that criminal prosecution may result in fine or

comprises all the facts of record in this case, did not indicate with any specificity the nature of the alleged criminal activity. For example, the stipulation did not indicate whether criminal activity involved the falsification of the taxpayer's individual return, or the falsification of the partnership return, or both. It did not disclose the taxpayer's business or income-producing activities during the relevant period in which the alleged criminal acts were committed; nor did it otherwise disclose any facts indicating that the fee expenditure in question was ordinary and necessary, partnership-wise, or that it qualified as a non-business expenditure, taxpayer-wise. (Pet. B-2—B-3, B-5.) In short, the stipulation failed to disclose that the alleged criminal acts were anything other than purely personal in nature.

It is apparent, therefore, contrary to the taxpayer's contention (Pet. 12-15), that this case does not project the general question whether an attorney's fee expended to forestall criminal prosecution is deductible under Section 23(a)(1)(A) and (2). As the Court of Appeals stated (Pet. B-5):

> We do not * * * reach the question of whether an attorney's fee expended to forestall criminal prosecution may, *under circumstances not here proved or stipulated*, be allowed as a deduction under either of those provisions. (Emphasis supplied.)

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imprisonment and hence, in economic loss to a taxpayer, such incidental consequences do not alone bring the expense of forestalling criminal prosecution within the ambit of Section 23(a)(2). *Lykes* v. *United States*, 343 U.S. 118, 126; *Port* v. *United States*, 163 F. Supp. 645, 647 (C. Cls.).

The taxpayer's contention (Pet. 13-14) that the court below erred in not allowing as a deduction the part of the attorney's fee which was paid for legal services relating to civil income tax liability is likewise without merit. Although such expenses are concededly deductible, if proved,[4] the Court of Appeals properly held that "As to such part of the fee, * * * the taxpayer failed to meet the burden of proving the amount to which he was entitled." (Pet. B-4.) See *Burnet* v. *Houston*, 283 U.S. 223, 227; *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *Nowland* v. *Commissioner*, 244 F. 2d 450, 454 (C.A. 4th); *Harden M. Loan Co.* v. *Commissioner*, 137 F. 2d 282, 284 (C.A. 10th), certiorari denied, 320 U.S. 791.

2. Contrary to the taxpayer's contention (Pet. 16-17), the trial court's denial of the motion to permit the taking of testimony to supplement the stipulation entered into between the parties involved no abuse of discretion or contravention of the federal rule calling for a just, speedy, and inexpensive determination of the case. The stipulation was correctly characterized by the Court of Appeals as a "carefully considered" one, entered into "at the suggestion of the plaintiff's attorney", with no "overreaching or

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[4] Legal expenses incurred in the determination of liability for taxes upon *income* are deductible. However, expenses incurred by an individual in contesting other liabilities (for example, gift taxes) are not deductible merely by reason of the fact that income-producing property held by the taxpayer may be used for the purpose of satisfying such liability. *Lykes* v. *United States*, 343 U.S. 118; Treasury Regulations 111, Section 29.23(a)-15 (Appendix, *infra*, pp. 11-13). And see fn. 3, pp. 5-6.

fraud," with not even a remote suggestion that it had been entered into "under misapprehension or without full knowledge of all the facts, or as the result of mistake." (Pet. B-6.) In the circumstances, the refusal to permit the stipulation to be supplemented (to afford the taxpayer an unwarranted opportunity to cure the fatal defect in his proof) was consistent with this Court's decision in *Carnegie Steel Co.* v. *Cambria Iron Co.*, 185 U.S. 403. See also *Aronstam* v. *All-Russian Cent. U. of Consumers' Soc.*, 270 Fed. 460, 464 (C.A. 2d); *Russell-Miller Milling Co.* v. *Todd*, 198 F. 2d 166, 168-169 (C.A. 5th). Moreover, the motion (in effect for a new trial) was made almost three months after the case had been tried, and, as the Court of Appeals observed (Pet. B-6), the taxpayer, as a condition precedent to the granting of the motion, was not even "willing to have the verdict set aside * * * so as to restore both sides to the position they were in before the stipulation was agreed on."[5]

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[5] At the time the parties agreed to the stipulation (February 6, 1957) two issues other than the attorneys' fee issue were in dispute. The "Debt Issue" was tried before a jury, and the jury returned a verdict thereon in favor of the taxpayer. Later, the Government conceded the other issue, the "Building Sales Issue." (Pet. B-5.)

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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CHARLES K. RICE,
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AUGUST, 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance

of property held for the production of income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23a)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See section 29.22(a)-5.) Among the items included in business expenses are management expenses, commissions (but see section 29.24-2), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see section 29.23(a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes,

whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provision of section 23, see section 24.

SEC. 29.23(a)-15. *Nontrade or Nonbusiness Expenses.—(a) In general.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23(a)(2) only upon the condition that:

> (1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and
>
> (2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

The term "income" for the purpose of section 23(a)(2) comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. * * *

Expenses, to be deductible under section 23(a)(2), must be "ordinary and necessary," which

presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) [As amended by T. D. 5513, 1946-1 Cum. Bull. 61] Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23(a)(1)(A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

* * * *

* * *. Expenses paid or incurred by an individual in the determination of liability for taxes upon his income are deductible. If property is held by an individual for the production of income, amounts expended in determining a property tax imposed with respect to such property during the period when so held are deductible. Expenses paid or incurred by an individual in determining or contesting any liability asserted against him do not become deductible, however, by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability. Thus, expenses paid or incurred by an individual in the determination of gift tax liability, except to the extent that such expenses are allocable to interest on a refund of gift taxes, are not deductible, even though property held by him for the production of income must be sold to satisfy an assessment for such

tax liability or even though, in the event of a claim for refund, the amount received will be held by him for the production of income.

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